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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 342

C. C. McCOLLUM, TRUSTEE IN BANKRUPTCY OF LOOKOUT PLANING MILLS,

Petitioner,

vs.

HAMILTON NATIONAL BANK OF CHATTANOOGA.

BRIEF OF HAMILTON NATIONAL BANK IN REPLY TO PETITION FOR CERTIORARI AND BRIEF OF PETITIONER.

SUBSTANTIAL FEDERAL QUESTION NOT INVOLVED.

Petitioner, C. C. McCollum, Trustee in Bankruptcy of Lookout Planing Mills, chose the Chancery Court, a State Court of Equity at Chattanooga, in which to bring this action for recovery of the penalty provided by the National Banking Act, United States Revised Statutes, Sections 5197, 5198, 12 U. S. C. A., Sections 85, 86 (R. 1, *et seq.*).

The Tennessee courts sustained the first ground of defendant's demurrer, and held that the Trustee in Bankruptcy was not the "legal representative" of the bankrupt, but that he was vested with power to maintain the suit by Section 70 of the Bankruptcy Act (R. 6, 10, 62, 74, 84).

Conforming to the method of pleading set-off in courts of equity in Tennessee, the Bank filed its answer as a cross-bill, praying that the $25,493.70 owing by the bankrupt to it be set off against any recovery for the penalty (R. 10 and 11).

American National Bank v. Warehouse & Elevator Co., 36 S. W., 960.

This suit was a direct action for the penalty, and the Chancellor awarded petitioner judgment for the penalty, amounting to $10,471.10, and set it off against the larger indebtedness of $25,493.70 owing by the bankrupt to the defendant Bank (Decree, R. 62, 63).

The Supreme Court of Tennessee affirmed the decree of the Chancellor in all respects (R. 82, 84).

Consequently, petitioner has successfully had his day in Court in a direct action for the penalty, and of that he does not complain. He seeks, however, a review of the final decree of the Supreme Court of Tennessee only in so far as that Court allowed set-off of the larger indebtedness of the bankrupt to the Bank against the judgment for penalty. The prayer of the petition is so limited by the following language:

"Wherefore your petitioner respectfully prays that certiorari be granted to review the decree of the Supreme Court of Tennessee * * * * * * * in so far as it provides that the amount of the indebtedness of the bankrupt to defendant shall be applied as set-off against the decree in favor of petitioner * * *."

It is thus admitted that the only question involved is the right of set-off, and no Federal question is presented for review within the terms of Section 237 (b) of the Judicial Code as Amended (28 U. S. C. A., Sec. 344-B).

STATE COURT, IN ALLOWING SET-OFF VIOLATED NO FEDERAL STATUTE OR DECISION.

(1) This suit, as aforesaid, was maintained under authority of Section 70 (a) of the Bankruptcy Act, which provided as follows:

"The trustee of the estate of a bankrupt, upon his appointment and qualification, and his successor or successors, if he shall have one or more, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt, as of the date he was adjudged a bankrupt, except that in so far as it is to property which is exempt, to all * * * * * * * (5) property which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him * * * * (6) rights of action arising upon contracts or from

the unlawful taking or detention of or injury to his property."
(11 U. S. C. A., Sec. 110).

By clause (5), the Trustee in Bankruptcy became vested with all assignable property and rights of action. Prior to the Bankruptcy Act rights of action for penalties and certain other rights of action were of doubtful assignability although arising from contracts or the unlawful taking of property. Therefore, clause (6) was added, making an action for the penalty an assignable right of action, and vesting the title of the bankrupt in the Trustee in Bankruptcy.

The following cases sustain the Supreme Court of Tennessee in holding that the Trustee in Bankruptcy can maintain a suit for the penalty:

National Bank of Jacksboro v. Lassiter, 196 U. S., 15, 49 L. Ed., 408;

Tiffany v. National Bank, 85 U. S., 409, 21 L. Ed., 862;

Read v. Am.-German National Bank, 155 Fed., 233;

Crocker v. First National Bank, 4 Dillon, 358; Fed. Cases, 3397;

Ripple v. Morgan, &c. Corp'n., 193 N. C., 422, 137 S. E., 156;

Monongahela National Bank v. Overholt, 96 Pa., 327.

Unless the Trustee had the right to maintain this action under the Bankruptcy Act the judgment for the penalty was void. If jurisdiction of the Court in this case rests upon Section 70 (a), the right of set-

off existed, and was allowable because these counter claims arose out of the same transaction and are mutual demands, subject to set-off under the Bankruptcy Act. Hence, no Federal rule was violated.

(2) Petitioner insists that the allowance of set-off conflicts with Section 68 of the Bankruptcy Act (11 U. S. C. A., Sec. 108), which provides:

> "(a) In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be applied or paid.
>
> "(b) A set-off or counter-claim shall not be allowed in favor of any debtor of the bankrupt which (1) is not provable against the estate."

Gilbert's Collier on Bankruptcy (4th ed.), page 1142, Sec. 1426, says:

> "This Section does not create the right of set-off, but recognizes its existence and provides a method by which it can be enforced even after bankruptcy. The provision is permissive and not mandatory, and does not enlarge the doctrine, and may not be invoked in cases where the general principles of set-off would not justify it. The determination is within the discretionary control of the Bankruptcy Court, to be exercised in accord with general principles of equity."

This text is supported by the following cases:

Stanley v. Boylston National Bank, 229 U. S., 523; 57 L. Ed., 1313;

Cumberland Glass Mfg. Company v. DeeWitt, 237 U. S., 447; 59 L. Ed., 1042;

In Re, Yamini Dry Goods Co., 295 Federal, 733.

The Bank's claim is a provable debt, and, the penalty sued for having grown out of the bankrupt's indebtedness to the Bank, the claims are mutual. That being true, the Trustee in Bankruptcy would be duty-bound to set-off one claim against the other and the balance only applied or paid:

In Re, Boyce Dry Goods Co., 133 Fed., 100.

Consequently, the allowance of set-off was within the true intent and meaning of the Bankruptcy Act, rather than in conflict with it:

Cumberland Glass Mfg. Company v. DeeWitt, 237 U. S., 447; 59 L. Ed., 1042.

The petitioner contends that the action is in tort, and the judgment therefore is not a debt. If that contention is right, the judgment for the penalty is void and the Court was without jurisdiction.

It is, however, under the express terms of the National Banking Act (12 U. S. C. A., Sec. 86), "an action in the nature of an action of debt," and while it is true that it has been held in the cases of *Barnet v. Muncie National Bank*, 98 U. S., 555, 25 L. Ed. 212, and *Haseltine v. Central National Bank*, 183 U. S., 132, 46 L. Ed., 118, that usurious interest exacted by a National Bank cannot be set off against an action for the debt, there is no Federal rule of law or decision that defendant has been able to find forbidding set-off of an indebtedness against the penalty in a suit brought to recover the penalty. The excess interest in this case was taken upon the indebtedness of the bankrupt to the Bank, and, manifestly, the claims are mutual, and grew out of the same transaction.

The Supreme Court of Tennessee aptly and correctly disposed of that contention in its Opinion in this case, filed for publication but not yet published, as follows:

> "The complainant, having invoked the jurisdiction of a court of equity, will be required to do equity by having his claim credited on the larger one owing to the defendant (fol. 107). Counsel insists that since a debtor when sued by a national bank cannot offset same with the penalty provided by section 86 of the National Banking Act *(Barnet v. Muncie National Bank*, 98 U. S. 555, 25 L. Ed., 212; *Bank v. Hunter*, 109 Tenn. 91) that where the situation is reversed the bank should not be permitted to offset its debts against the penalty. There is an obvious distinction in the two cases. Section 86 of the Banking Act, being of a penal nature, is to be strictly construed. *Tiffany v. National Bank*, 18 Wallace, 409, 21 L. Ed., 862. The form of remedy for its enforcement is therefore exclusive. *Barnet v. Muncie National Bank, supra;* 25 C. J., 1185. It necessarily follows that the penalty can only be recovered in an independent action of debt, as directed in the act. Having obtained a decree for the penalty, there is no provision in the Banking or Bankruptcy Acts restricting or prohibiting the bank from offsetting same with any just debt owing to it by the bankrupt, and, as previously stated, this is expressly authorized by our statute." (R. 82).

The original indebtedness of petitioner to defendant was $45,000.00, of which, at the time of bankruptcy, an unpaid balance remained of $25,493.70. Within two years of filing of this suit for penalty the bankrupt has paid $5,235.55 excess interest. Thus

the unpaid balance of the original indebtedness was larger than the penalty at the time of bankruptcy (R. 56, 57, 62, 63). It seems, therefore, that allowance of set-off was equitable, was within the spirit of Section 68 of the Bankruptcy Act, and that no Federal question is involved.

(3) Set-off was properly allowed, under general principles of equity. Section 68 of the Bankruptcy Act applies general principles of equity to the right of set-off after bankruptcy.

Section 8768, Code of Tennessee, provides:

> "The defendant may plead by way of set-off or cross-action:
>
> "(1) Mutual demands held by the defendant against the plaintiff at the time of action brought, and matured when offered in set-off;
>
> "(2) Any matters arising out of the plaintiff's demand, and for which the defendant would be entitled to recover in a cross-action;
>
> "(3) Any matter growing out of the original consideration of any written instrument, for which the defendant would be entitled to recover in a cross-action."

The foregoing statute expresses the equitable policy of the State, and a Trustee in Bankruptcy who brings an action in the Chancery Court must do equity by allowing set-off in all proper cases:

Sartin v. Dixie Coal and Iron Company, 150 Tenn., 633.

In Re, Boyce Dry Goods Co., 133 Fed., 100;

In Re, Harper, 175 Fed., 412.

Having come into a Court of Equity, complainant must do equity. This principle is sustained by 24 R. C. L., 843, Section 48, as follows:

> "Equitable Set-off.—Bankruptcy and Insolvency statutes have generally permitted a set-off of mutual credits, whether due or not, and have, therefore, administered a much broader equity than the ordinary law of set-off, which does not generally permit a debt due at a future time to be set off in equity against a debt presently due. But a court of equity has power to permit an equitable set-off in cases not within the statute, if, from the nature of the claim or the situation of the parties, justice cannot be obtained by a cross-action. Thus where there are, upon accounts, mutual credits between two parties, though they cannot be set off at law, yet it is the common ground of a bill in equity. And it has frequently been held that set-off based on insolvency may be allowed in equity notwithstanding the claim of the defendant was not mature at the time of the commencement of the action. If both parties were solvent, so that both debts might ultimately be collected, the law would afford adequate relief, and no injustice would be wrought to either party. The one could not suffer by having to pay his own debt according to his contract, if he could ultimately compel the other to pay his debt according to his contract. But it is this very fact that, if the one pays the debt due from him, he cannot compel payment of the debt due him, and will thereby suffer irreparable loss, and his inability to protect himself by set-off at law because his debt is not due, that create his equity, and the necessity for equitable relief."

This text is supported by the following cases:

Schuler v. Israel, 120 U. S. 506, 30 L. Ed., 707;
Nashville Trust Co. v. Nashville Fourth National Bank, 91 Tenn., 336.

These claims arose out of the same transaction.

In all such cases, according to the almost universal rule, the right of set-off or recoupment existed. In 24 R. C. L., 844, Section 49, that rule is stated as follows:

> "The usual provision of the codes is that a counter-claim may consist of a demand arising out of the contract or transaction set forth in the complaint as the foundation of the plaintiff's claim, or connected with the subject of the action; and in an action arising on contract, any other cause of action arising also on contract and existing at the commencement of the action. The clear intention of the framers of the codes was that the court in one action should settle all matters in controversy relating to the contract or transaction which is the foundation of the suit. Any cause of action, therefore, whatever its nature, arising out of the cause of action alleged in the complaint, or connected therewith, in favor of the defendant, and against the plaintiff, is a proper counter-claim. Any other construction would frequently defeat the ends of justice by preventing a full examination of the matter in controversy, where the rights of the parties were so dependent upon each other that they must necessarily be considered together to render a correct judgment. When the cause of action arises out of the transaction or is connected with the subject of the action, it may be pleaded as a counter-claim without regard to its character,

and it is only where the causes of action sought to be counter-claimed arises upon an independent contract that it becomes material that the cause of action so sought to be counter-claimed should be one on contract and existing at the time of the commencement of the action."

(4) After the penalty has been reduced to judgment certainly it is subject to set-off. In 13 R. C. L., page 675, it is said:

> "So a judgment in favor of the receiver of a corporation against a National Bank for twice the amount of interest unlawfully taken by the Bank, is subject to a set-off, in favor of the Bank, of judgments thereafter recovered by the Bank on the note on which the usurious interest was taken."

This rule is sustained by the case of *Barbour v. National Exchange Bank*, 50 Ohio State, 90, 20 L. R. A., 192, wherein it is said:

> "But, after the appointment of a receiver, the respective demands of the Bank and Shoe Company were put into judgment, and thereafter they stood on a level as the subjects of equitable set-off, whether arising on contract, or growing out of a forfeiture or penalty. * * * * * * *
>
> "Any defense or set-off which the debtor might have urged in an action brought against him by the corporation itself may still be made in an action brought against him by the receiver. High on Receivers, Sec. 318. The Shoe Company, at and from the appointment of the receiver, was insolvent, and if, before the receivership, the Shoe Company, while thus insolvent, had sued the Bank to recover the penalty for taking excess

> interest, and if the Bank could not then have had the right of set-off under the statute, yet on just and equitable grounds, and upon a proper valuation of the Bank's claims not matured, we think the Bank would have been entitled to an equitable set-off against the claim of the Shoe Company; nor would such an equity in favor of the Bank have ceased to exist because afterwards a receiver came in to wind up the affairs of the insolvent Shoe Company."

The penalty was reduced to judgment in this suit. The requirement of the Banking Act as to form of the suit has been met. The judgment became, even if the right of action had not before been, an asset of the bankrupt estate, subject to set-off against the claim of defendant Bank. The debt was set off against the judgment for the penalty. The fact that the set-off was allowed in the suit for the penalty by cross-action is not material. If judgments for the penalty and for the debt had been obtained in different courts, or in the same court in different suits, certainly one judgment could be set off against the other. Then, what good reason can be assigned why set-off by cross-action may not be allowed?

(5) The right of set-off against a penalty exists by the express statute of Tennessee. Section 8769, Code of Tennessee, provides:

> "Mutual debts, though of a different nature, between the parties to a suit; or between testator or intestate of both or either party, may be set off against the other by being pleaded in bar or in discharge of the action, either wholly or in part, as the case may be, and if either debt arose

by reason of a penalty the sum intended to be set off, shall be pleaded in bar, setting forth what is justly due on either side."

This statute (the Code is a statutory enactment) should be, and is, controlling.

Petitioner elected to sue in the State Court, and is subject to State laws, in the absence of conflict with Federal laws. He who enters a court of equity must do equity, and the doing of equity does not conflict with Federal law or decisions.

Therefore, no substantial Federal question is presented by the petition for certiorari, and it should be denied.

J. B. SIZER,
Provident Building,
Chattanooga, Tennessee,
Counsel for Defendant.

C. W. K. MEACHAM,
W. D. MOON,
Hamilton National Bank Building,
Chattanooga, Tennessee,
Of Counsel.

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SUPREME COURT OF THE UNITED STATES.

No. 342.—October Term, 1937.

C. C. McCollum, Trustee in Bankruptcy of Lookout Planing Mills, Petitioner, *vs.* Hamilton National Bank of Chattanooga. | On Writ of Certiorari to the Supreme Court of the State of Tennessee.

[February 28, 1938.]

Mr. Justice Butler delivered the opinion of the Court.

Section 5197, Revised Statutes,[1] governs the rates of interest to be taken by national banking associations and § 5198[2] declares that the receiving of a rate of interest greater than that allowed, when knowingly done, shall be deemed a forfeiture of the entire interest and provides that, in case a greater rate has been paid, the person paying it may recover back twice the amount, in a suit in the nature of an action of debt. Petitioner is trustee in bankruptcy of Lookout Planing Mills, a corporation. He brought this suit under § 5198 in the chancery court of Hamilton County, Tennessee, to recover from respondent the penalty imposed by that section. Respondent answered denying liability, and by cross-bill alleged the bankrupt owed it $25,493.70 on notes, and prayed that it be allowed to set off its claim against any judgment that petitioner might obtain. Petitioner's answer to the cross-bill asserted that recovery of the penalty did not depend on payment of the debt.

The chancellor found that the bankrupt paid and respondent knowingly received $5,235.55 as interest based on a rate in excess of that permitted and gave him judgment for double that amount.

[1] 12 U. S. C., § 85.

[2] 12 U. S. C., § 86: "The taking, receiving, reserving, or charging a rate of interest greater than is allowed by the preceding section, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back, in an action in the nature of an action of debt, twice the amount of the interest thus paid from the association taking or receiving the same: Provided, That such action is commenced within two years from the time the usurious transaction occurred."

He ruled that after judgment petitioner's claim was subject to set-off and ordered that the amount awarded him be applied as a credit upon the debt. The state supreme court held the set-off permissible under the Bankruptcy Act, § 68 (a), and expressly authorized by § 8769 of the Tennessee Code and declared that petitioner would be required to do equity by having his claim credited on the larger one owing to the respondent by the bankrupt.

The question is whether respondent is entitled to have the amount of the judgment for penalty credited on its claim against the bankrupt estate.

When the bank knowingly received illegal interest, it immediately became liable for, and the borrower became entitled to recover from it, a penalty of twice the amount of the interest thus paid. *Farmers etc. National Bank* v. *Dearing,* 91 U. S. 29. *Lake Benton First National Bank* v. *Watt,* 184 U. S. 151. Upon petitioner's appointment as trustee in bankruptcy, the bankrupt's right to recover the penalty vested in him. Bankruptcy Act, § 70 (a), 11 U. S. C. § 110 (a). *First National Bank* v. *Lasater,* 196 U. S. 115, 118. *Reed* v. *American-German National Bank,* 155 Fed. 233. The penalty is to be enforced according to the terms of the statute. Guilt being established, the law itself fixes the punishment at precisely twice the usurious exaction paid; it may not be enhanced or mitigated because of aggravating circumstances or equitable considerations. As the sum demanded is certain, recovery in an action of debt is authorized, though the claim arises not in contract but in tort. *Chaffee & Co.* v. *United States,* 18 Wall. 516, 538. The liability can only be enforced in an action "brought specially and exclusively for that purpose,—where the sole issue is the guilt or innocence of the accused, without the presence of any extraneous facts which might confuse the case". *Barnet* v. *National Bank,* 98 U. S. 555, 559. One paying a national bank usurious interest and entitled to enforce the penalty may not recover it by way of set-off in a suit brought upon his note to the bank. *Haseltine* v. *Cent. Bk. of Springfield,* 183 U. S. 132, 137. *Barnet* v. *National Bank, supra. Dreisbach* v. *National Bank,* 104 U. S. 52. *Stephens* v. *Monongahela Bank,* 111 U. S. 197. See *Schuyler Nat. Bk.* v. *Gadsden,* 191 U. S. 451, 456.

Reasons, at least as cogent as those that uphold that rule, support the contention that the state court erred in permitting re-

spondent to credit the amount of petitioner's judgment for penalty upon the notes given it by the bankrupt. To allow respondent to satisfy the judgment for penalty by mere deduction from its claim against the bankrupt's estate is to detract from the punishment definitely prescribed. The sentence specifically required by the law may not be cut down by implication, set-off or construction; for that would narrow the statute and tend to defeat its purpose. See *United States* v. *Wiltberger,* 5 Wheat. 76, 95. *Fasulo* v. *United States,* 272 U. S. 620, 628.

The right of set-off here involved does not at all depend upon the Tennessee statute upon which, at least in part, the state supreme court rested its ruling. Sections 5197 and 5198, Revised Statutes, define petitioner's right to recover, and respondent's liability for, the penalty; the Bankruptcy Act governs liquidation and distribution of the bankrupt's estate. It results that the validity of the challenged provision of the decree depends upon the right of set-off in bankruptcy. Bankruptcy Act, § 68 (a), 11 U. S. C. § 108 (a). Cf. *Yates* v. *Jones National Bank,* 206 U. S. 158, 179. *Farmers etc. National Bank* v. *Dearing, supra. McDaniel National Bank* v. *Bridwell,* 74 F. (2d) 331.

Section 68 (a) declares: "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed and paid." The words "debts" and "credits" as there used are correlative. What is a debt on one side is a credit on the other. *Libby* v. *Hopkins,* 104 U. S. 303, 309. Liability for the penalty does not arise in contract but is laid *in invitum* as a disciplinary measure. Nor does the judgment determining the extent of guilt and declaring sentence change the liability for penalty to one for debt. *Chase* v. *Curtis,* 113 U. S. 452, 463-464. *Boynton* v. *Hall,* 121 U. S. 457, 465-466.

As the penalty may be enforced only in a suit brought exclusively for that purpose so that the trial of guilt or innocence may not be embarrassed by any other question, it is plain that the payment of any debt owed by the plaintiff to the bank may not be held a condition precedent to the determination of that issue. Punishment for usury does not depend upon payment of the borrower's debt. It follows that respondent is not entitled to satisfy petitioner's judgment by deducting the amount of it from re-

spondent's claim against the bankrupt's estate. *Meredith* v. *Bank*, 127 Tenn. 90, 94. *Exeter Nat. Bank* v. *Orchard*, 43 Neb. 579, 582. *Morehouse* v. *Second National Bank*, 37 Hun 628. Reason, well supported by authority, requires that the penalty for usury so specifically prescribed shall be paid according to the terms of the statute.

Reversed.

Mr. Justice CARDOZO took no part in the consideration or decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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